

The World's Greatest Investors



Clockwise from top right: Thyra Zerhusen, David Herro, Susan Byrne, Warren Buffett. (Photograph by Mark Weiss, portrait illustrations by Keith Witmer.)

If the stock markets were a public beach, the red “high hazard” flags might still be flying over the lifeguard’s chair. Or at the very least, a strong yellow. The summer has been calmer than the spring, but not by much, not with the foundering euro and stubborn unemployment at home offering daily reminders that global economic waters are still choppy. And the stock market remains as riptide-prone as ever. According to Schaeffer’s Investment Research, the Dow is on pace to register 90 days this year with swings of 100 points or more—more than twice as many as in any of the three years before the crash. As fund managers keep warning, many of last year’s top-performing stocks were risky or near-death companies that now are struggling once again. Small wonder that many mainstream investors remain anxiously on shore—collectively, Americans hold \$9.4 trillion in cash, 27 percent more than in 2007.

Of course, where fearful investors see threatening surf, the most successful pros see big-kahuna waves that they can ride to profits. We focused this year’s installment of “The World’s Greatest Investors” on four people who’ve proved they can make good money in stocks even in difficult times. And indeed, some were more upbeat after the market’s ugly summer tumbles than they were before it—after all, their favorite stocks were cheaper.

That said, these managers are anything but blasé about the rough market—and, for what it’s worth, none of them believes that new financial regulations will affect their portfolios much—yet. With a combined 100 years’ investment experience among them, they’re being selective and disciplined as they decide which stocks are safe to own. Susan Byrne, a veteran of many decades in the mutual fund world, is moving into big conglomerates that pay fat dividends; Thyra Zerhusen likes smaller firms that dominate niche markets, especially in tech or industrials. International-investing specialist David Herro thinks the best way to ride out the market’s turmoil is to buy stocks in Europe—even though Europe instigated much of that turmoil. And even the venerable Warren Buffett has been reshaping the sprawling Berkshire Hathaway empire to make it less vulnerable to the market’s unpredictable tides. For more about how these proven veterans are balancing caution and opportunism, read on.

Warren Buffett

CEO, Berkshire Hathaway

At a recent Omaha bridge game, Warren Buffett was asked about his smart-looking navy jacket. Buffett opened it and flashed a custom-made Chinese label. “I have a whole closetful,” he said. The chairman of Berkshire Hathaway is usually eager to buy American brands like General Electric, Coca-Cola and Harley-Davidson for his investment portfolio—but when the price is right elsewhere, he’ll change direction. And as it turns out, he’s just as willing to make over his company as he is his wardrobe.

Buffett’s 44-year investment record at the helm of Berkshire is the stuff of legend. The 20 percent-a-year increase in the company’s book value per share—the company’s assets minus its liabilities—is more than double the S&P 500’s 9.3 percent return over the same stretch. This month Buffett celebrates 80 years on this planet. He’s fond of joking how he plans “to work until six years after” his death. But judging by his recent actions, the significance of his age is not lost on him. With a few deft moves, he has put Berkshire on something closer to autopilot, and some Buffettologists think he’s preparing for the day he no longer sits at the helm. “Buffett is foolproofing his portfolio,” says Paul Lountzis, a Wyomissing, Pa., asset manager whose portfolio includes

Berkshire shares.

The end result: a company that relies much more on day-to-day corporate earnings for its revenue—and less on stock and bond investing. In 2009 revenue from Berkshire's manufacturing, service and retail companies totaled \$61.7 billion, up from just \$5.7 billion in 1999, while earnings from Uncle Warren's investment portfolio have declined as a share of revenue. No move underscored this change in emphasis more than Buffett's groundbreaking \$26.3 billion acquisition of Burlington Northern Santa Fe. To help raise money for the purchase, Berkshire sold shares of long-held names like Johnson & Johnson, Procter & Gamble and Kraft. And other signs have recently emerged that Buffett is less inclined to play the market: At his 2010 annual shareholder's meeting, Buffett and longtime partner Charlie Munger floated the possibility of paying a dividend, a previously sacrilegious idea that would further shrink Berkshire's pool of investable money.

All this means that whoever assumes the reins from Buffett will be managing a very different company. In 2008, Buffett announced a horse race for his successor as chief investment officer, with four secret candidates. The timetable for a transition is anyone's guess, and Buffett declined to comment for this article. But at the annual meeting, Munger, 86, dropped a strong hint, saying the firm would add an investment person "sooner rather than later." One thing is certain: Even with a smaller pool of capital, he or she will have a big suit to fill.

Buffett's Picks

Buffett has sold shares of some of his favorite names over the past year, but he's quietly bought these companies' stock.

Republic Services (RSG¹)

Fast-growing waste-management company also pays a healthy dividend.

Becton Dickinson (BDX²)

Uncertainty about health care reform made shares of this medical-device maker look cheap.

Iron Mountain (IRM³)

Information-management firm is benefiting from fears about cyber-snooping.

Tesco (TSCDY⁴)

UK-based 4,800-store chain has been adept at adapting to local markets worldwide—including, since 2007, in the U.S.

Thyra Zerhusen

Chief Investment Officer, Optimum Investment Advisors

Whenever Chicago's weather permits, Thyra Zerhusen bikes or skates to work. But the German-born money manager tries to avoid the streets, riding instead through the park or on sidewalks. "I'm very cautious and a bit paranoid," Zerhusen admits.

Apparently, a little paranoia pays. Fixating on what can go wrong with her portfolio has helped Zerhusen quietly trounce the market. Over the past decade, her Aston/Optimum Mid-Cap Equity fund has averaged returns of almost 9 percent a year, beating 96 percent of her peers, according to Morningstar. That's 10 percentage points better than the S&P 500 over the same period. Taking a page from the Buffett playbook, Zerhusen invests in a smaller-than-usual mix of 35 to 40 companies and sticks with them. "She doesn't do the obvious thing, but that's the mark of a good investor," says David Kathman, a fund analyst at Morningstar. And her performance has helped assets in the fund soar, from \$20 million in 1999 to \$1.7 billion today.

Investing wasn't Zerhusen's original goal; the trilingual European majored in life sciences in Zurich and interned on irrigation projects in Tunisia. But she found little use for that experience after moving as a newlywed to the Chicago suburbs, so she earned a master's degree in economics. After 16 years as a stock analyst, Zerhusen finally got the chance to manage money in the mid-1990s. She has always specialized in midcap companies with market capitalization ranging from \$1 billion to \$12 billion. These stocks, she says, are "largely ignored"—something the low-profile Zerhusen could say about herself.

The companies she buys have a few common elements: They're focused on one or two business lines and sell must-have services or products. Comparing price/sales or price/earnings ratios to a company's growth helps her gauge whether she's looking at a bargain. Plenty of her picks have inspired skepticism; in 2002 colleagues questioned her decision to buy Reuters as the firm struggled after the tech crash. But Zerhusen saw a company that was standing on the brink of a turnaround and trading cheaply. "Your best ideas are often when people think you are crazy," she says (her Reuters investment quadrupled).

Zerhusen, who declines to give her age except to say she is younger than Buffett, says she's still amazed by last year's recovery. But this year's market dive didn't faze her; in her view, news about Europe "just spooked people." When the market dipped, she bought out-of-favor stocks like media giant Gannett and speech-technology firm Nuance Communications. Meanwhile, improved earnings this spring and reports of components shortages have provided her first sense of comfort about the economy. "I wouldn't have said it a month ago, but I think the recovery has legs," she says.

Zerhusen's Picks

Zerhusen looks for bargains among what she calls "largely ignored" midcap companies like these.

Molex (MOLX⁵)

Industrial-components firm benefits from demand for smaller, more-complex mobile phones.

Akamai (AKAM⁶)

Its technology speeds up delivery of Internet video and e-commerce.

Nuance Communications (NUAN⁷)

A voice recognition technology firm catering to the health care market; its software even understood Zerhusen's German-inflected English.

BorgWarner (BWA⁸)

An auto parts maker that Zerhusen says has a terrific management team and strong growth abroad.

David Herro

Portfolio Co-Manager, Oakmark International Fund

Don't be surprised if you see David Herro rifling through the Starbucks tip jar. The comanager of the \$5.2 billion Oakmark International fund isn't looking for change to pay for his skim mocha. He's searching for wheat pennies minted before the 1930s—some of which are worth hundreds of dollars today. Yes, his scavenging draws weird looks, but that's normal for Herro, whether he's collecting or investing.

When investors fled emerging markets after the Asian currency crisis in 1998, Herro loaded up. When oil prices soared, he avoided energy stocks. With money now flooding into countries like Brazil and China, Herro's exposure to emerging markets is a measly 7 percent. Once a stock sector gets hot, says the boyish 49-year-old, "people like the story—and we avoid those." So what does Herro like right now? Europe, the continent whose recent debt woes have sent investors scurrying for cover.

Going against the herd has helped Herro, a native of Wisconsin dairy country, beat 99 percent of his peers over the past decade. During that period, his fund returned almost 8 percent a year, surpassing the MSCI EAFE index of global stocks by seven percentage points. "He is willing to wait until the world comes around to his thinking," says Jeremy DeGroot, chief investment officer of asset-management firm Litman/Gregory, which Herro helps advise. That means he often disagrees with other investors about what qualifies as a bargain. A car buff, Herro likens the stocks he owns to BMW330s, rather than dirt-cheap, "junk" Yugos. His example of a Beemer: luxury retailer Richemont, which seems pricey compared with some stocks but is a better value, thanks to its profitability and extensive reach in the developing world.

To back up his convictions, he and his staff travel overseas regularly, meeting not just with companies they're thinking of buying but also with their rivals, distributors and controlling shareholders. These days, while Herro stops short of calling emerging markets a bubble, he thinks European and Japanese blue chips are a better way to tap growth abroad. About 60 percent of his fund is invested in Europe, despite the region's debt crisis. Herro thinks the sinking euro will ultimately help the continent's economy, and he's willing to buy companies whose long-term viability isn't threatened—he recently scooped up shares of Richemont and Spain's Banco Santander.

Herro is also holding on to some of his 2009 winners, since he thinks many of them have successfully boosted their competitiveness. That sentiment also puts him out of step with conventional wisdom, but if it yields the portfolio equivalent of a bunch of wheat pennies, he won't mind. "People are spoon-fed so much," he says. "You can't be afraid to be different."

Herro's Picks

Herro, going against the grain, sees significant growth potential for stocks in Europe and Japan.

GlaxoSmithKline (GSK⁹)

Pharmaceutical giant gets a boost from its consumer health care business.

Allianz (AZSEY¹⁰)

Asset-management firm should benefit as investors, fearful about government pensions, start saving more.

Rohm (ROHCY¹¹)

Japanese semiconductor maker is benefiting as tech firms start to restock.

Banco Santander (STD¹²)

The Spanish bank's huge presence in Latin America, including Brazil, should help it offset damage from economic weakness in Europe.

Richemont (CFR.VX)

Luxury retailer with extensive reach in the developing world.

Susan Byrne

Chief Investment Officer, Westwood Holdings

Susan Byrne, 63, is a bit peeved at younger investors. "You buy stocks to increase your purchasing power," says the investment

guru of the \$10.6 billion Westwood Holdings Group—and with a dividend that grows at nearly 15 percent a year, your income doubles every five years. But “to a whole generation of people, it’s boring,” she laments. “Nobody wants to invest in a serious, long-term way.”

The voluble grandmother of seven doesn’t often stand on a soapbox—40 years of investment experience speaks loudly enough. Her irritation may come from looking back at the market’s performance in the past couple of years. Byrne has made her reputation as a disciplined bottom-fisher of underpriced and cash-rich companies. That means her funds can fall behind in a roaring upturn like 2009’s, when high-risk companies thrived while her fund lagged her large-cap peers by 16 percentage points. Still, her philosophy also helped her dodge the AIG, Lehman and Fanny Mae torpedoes during the crash. And her flagship Gamco Westwood Equity has outpaced the S&P 500 over the long term. Over 15 years, she’s averaged 8 percent a year, versus the market’s 7 percent. (Her less expensive WHG funds are also strong performers.)

Brought up a self-described “in-charge person,” as the oldest of six kids in a Pasadena, Calif., family, Byrne exudes the confidence of someone who has always believed she could do whatever she wanted. Her approach to stock selection begins with a bird’s-eye view of the economy and a decision on which sectors have the best growth prospects. Lately, that’s drawn her to Xerox, Cummins and Honeywell—cash-rich industrial companies that she thinks will fare well even if the recovery is slow. And the fact that these companies lagged during last year’s bull market doesn’t concern clients like the Missouri teachers retirement system, for whom Westwood manages \$825 million. “We wouldn’t expect her high-quality stocks to surge in a period that favored higher-risk, junkier companies,” notes Craig Husting, the system’s chief investment officer.

In Byrne’s view, the country is three to four years into a seven-year cycle, during which overall growth will be tepid. Forget a V-shaped recovery; it will be “square rootish,” she says. Byrne is bemused to see that big business hasn’t been borrowing at today’s ultralow rates to pave the way for future growth. “It’s like they’re standing in a courtyard three feet deep in \$100 bills,” she says, “but no one will pick up those bills!” So for now, as businesses and households reduce debt, Byrne continues to gravitate toward familiar, brand-name companies with growing dividends. “There’s a time for older, more mature companies,” she says. And if investors see her as a trusted brand, she’ll happily accept the comparison.

Byrne’s Picks

Byrne is navigating what she sees as a slow recovery by sticking with big, cash-rich industrial companies.

ITT (*ITT*¹³)

Major conglomerate should see a boost from its water-purification technology.

Honeywell International (*HON*¹⁴)

Took a hit during the housing slump, but has strong prospects in energy-efficient heating and cooling.

Cummins (*CMI*¹⁵)

Seeing strong demand for its generators and its cleaner truck engines.

Metropolitan Life (*MET*¹⁶)

The insurer’s purchase of AIG’s Asian insurance unit should boost its international exposure as well as its earnings.

Franklin Resources (*BEN*¹⁷)

The \$600 billion money manager is flush with cash from its popular income-oriented funds and is a likely candidate to issue an ample dividend.

¹<http://www.smartmoney.com/quote/RSG/>

²<http://www.smartmoney.com/quote/BDX/>

³<http://www.smartmoney.com/quote/IRM/>

⁴<http://www.smartmoney.com/quote/TSCDY/>

⁵<http://www.smartmoney.com/quote/MOLX/>

⁶<http://www.smartmoney.com/quote/AKAM/>

⁷<http://www.smartmoney.com/quote/NUAN/>

⁸<http://www.smartmoney.com/quote/BWA/>

⁹<http://www.smartmoney.com/quote/GSK/>

¹⁰<http://www.smartmoney.com/quote/AZSEY/>

¹¹<http://www.smartmoney.com/quote/ROHCY/>

¹²<http://www.smartmoney.com/quote/STD/>

¹³<http://www.smartmoney.com/quote/ITT/>

¹⁴<http://www.smartmoney.com/quote/HON/>

¹⁵<http://www.smartmoney.com/quote/CMI/>

¹⁶<http://www.smartmoney.com/quote/MET/>

¹⁷<http://www.smartmoney.com/quote/BEN/>

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